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**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Implement the Commission's Procurement Incentive Framework And to Examine the Integration of Greenhouse Gas Emissions Standards into Procurement Policies	))))	Rulemaking 06-04-009 (Filed April 13, 2006)

**ENERGY RESOURCES CONSERVATION AND DEVELOPMENT COMMISSION
OF THE STATE OF CALIFORNIA**

In the Matter of: Order Instituting Informational Proceeding on a Greenhouse Gas Emissions Cap	)))	Docket 07-OIIP-01

REPLY COMMENTS OF THE MODESTO IRRIGATION DISTRICT ON ALLOWANCE ALLOCATION ISSUES

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November 14, 2007

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In accordance with Rules of Practice and Procedure of the Public Utilities Commission ("CPUC") of the State of California, and the Administrative Law Judge's Ruling Requesting Comments and Noticing Workshop on Allowance Allocation Issues issued October 15, 2007 in Rulemaking 06-04-009 ("Ruling"), the Modesto Irrigation District ("Modesto ID") hereby files these Reply Comments ("Reply Comments") on Allowance Allocation Issues. Modesto ID also files these Reply Comments with the California Energy Commission ("CEC") in Docket 07-OIIP-01. In these Reply Comments, the CPUC and CEC will collectively be called the "Joint Agencies."

On October 31, 2007, numerous parties submitted comments responding to Questions posed by the Joint Agencies. There appeared to be general consensus that any market based system that is implemented should be designed to minimize the cost impact to consumers while achieving real emissions reductions. Any such system must achieve this goal in a fair and equitable manner that accounts for early emission reduction activities and load growth while avoiding the creation of "windfalls" for any market participant. Modesto ID concurs with those comments supporting administrative allocation of emission allowances based at least initially on emission output. Any auctioning of allowances should be phased in gradually after a robust market has developed. Modesto ID also concurs with comments that propose the value derived from emission allowances be used for the benefit of the ratepayers who ultimately bear the costs of emission reductions.

Any Auction of Allowances Must be Phased in Gradually After a Market Develops and Matures.

Several parties submitted comments supporting auctioning of emission allowances, citing price transparency and open access. However, the equitable interests of the electric consumer have to outweigh any interests of those that plan to make a profit on the auction and trading of allowances. If the Joint Agencies determine that some portion of emission allowances should be auctioned, the market must be gradually developed with administratively allocated allowances and allowed to mature before auctions are instituted. Any transition to auction should be gradual, starting with a small portion of the market, to ensure that the emission allowance market is well established and experienced. Such a cautious approach is necessary in order to avoid manipulation, fraud and other market abuses. As Modesto ID and others noted in opening comments, a single identifiable market monitor will be crucial. The establishment of a well monitored auction system will itself provide price transparency (price transparency being different from the market efficiency that may come with trading in a deep, mature market).

Submitted comments also recognized that whether allowances are allocated or auction proceeds are allocated, the value of the emission allowances must be apportioned in a manner that achieves the goals of AB 32. Most parties agree that in some fashion such value should be used to benefit the consumers. Most also agree that this benefit is achieved through funding of emission reduction programs, including energy efficiency and technological advancements. The most efficient way to ensure that the value generated through emission allowances is returned to the consumers is for the retail providers serving those customers to invest such value in programs designed to achieve emission reductions. In addition to energy efficiency, acceptable programs would include replacement of high carbon resources, research and development of clean energy resources, electrification of emission sources from other sectors, and investment in transmission that improves access to cleaner resources. Thus, proceeds from any auction should in some significant part be apportioned to the retail providers for such targeted use. Because the value would be directed into emission reduction activities such a program would not result in any wealth transfer or windfalls. Any amounts not so apportioned should likewise be used for direct emission reduction activities – albeit on a statewide or more global basis. As was pointed out, however, protections must be provided to guarantee that such amounts are not misappropriated to other uses.

A gradual transition to an auction process, if at all, is further supported by those parties that proposed a two-step approach to apportioning auction proceeds. First, emission allowances (or the value of the allowances) would be allocated to the retail providers for the benefit of the consumers that they serve and only after such allocation would the allowances be auctioned. This two-step approach separates the eventual auction from the point of regulation and opens it to all regulated parties in need of emission allowances. It would also achieve price transparency by establishing the allowance value through the auction process. However, windfalls could be avoided by proper pre-auction allocation of the allowance values.

Allocation Methodology Must Account for Early Reduction Activities, Load Growth and Climate Driven (Hydro) Fluctuations.

Different parties advocate for different allocation methodologies generally dependent upon the carbon emission factors of their resource mix and their anticipated load growth. A few notable exceptions have proposed that an allocation methodology be adopted based initially on historical emissions (or output) transitioning over time to a load (or sales) based allocation. Modesto ID agrees that such transition approach would best accomplish the AB 32 reduction goals. Any allocation methodology must be designed with the clear understanding that the overriding mandate to reduce emissions to regulated levels will ensure that all parties have sufficient impetus to undertake emission reduction activities as quickly and as effectively as possible. As numerous comments point out, however allowance values are allocated there will not be sufficient allowances to cover all emissions.

All parties appear to agree that the methodology adopted for allocating the value of emission allowances must account for load growth and climate fluctuations. Existing forecasts show projected load growth well into the compliance period. Understanding that such forecasts must be adjusted for anticipated electrification activities in other sectors, and for some acceptable margins of error, these growth patterns must be recognized. Utilities more highly impacted by such growth cannot be penalized.

Many parties have also pointed out that loads and emission factors are heavily impacted by differing climates and fluctuating water years. They propose, regardless of the allocation methodology, a multi-year baseline to smooth these fluctuations. Although Modesto ID did not advocate a multi-year baseline in its Opening Comments, it agrees with those parties who have. A multi-year baseline based on verifiable data that existed prior to the implementation of AB 32 will address climate variations and water fluctuations without influencing either the manipulation of or the avoidance of early reduction activities.

Modesto ID strongly disagrees with any allocation methodology that bifurcates the state into regions. This approach is artificial and is based on faulty generalizations. Not all utilities in the northern portion of the state have significant hydroelectric resources and not all utilities in the southern portion of the state have high carbon resources. In fact, some northern utilities are high carbon and some southern utilities have large hydro resources. Moreover, the bifurcated approach fails to recognize that implementing and achieving the goals of AB 32 requires a statewide, if not regional or national, effort. Any dual system, in addition to the administrative costs, will further divide those within the state that must work together to achieve the mandated emission reductions. It serves no purpose to add to the complexity of the already confounding issues before the Joint Agencies by splitting emission allowances between portions of the State and trying to develop multiple allocation systems.

Evaluation Criteria for Emission Allowance Allocation Methodologies Must Include System Reliability and Resource Adequacy.

A poorly designed allowance allocation methodology could impede national, regional and local efforts to bolster grid reliability as mandated in the 2005 Energy Policy Act. In the near-term, allowances must be distributed to all generators that provide necessary system support and ancillary services if the Western Grid is to remain resource adequate. Allocations can be scaled back over time, as Load Serving Entities begin to replace or retrofit higher carbon emitting generators with new technology, however caution should be taken to perform this in a planned and coordinated manner that preserves reliability and resource adequacy. A fundamental principle of the emission allocation system must be to preserve the integrity and reliability of the grid as the transition is made to cleaner generating resources.

The Joint Agencies Should Consider Including Safety Valves as Part of Any Market System for Emission Allowances.

Parties have recommended the inclusion of various “safety valves” such as allowance banking and offset purchases as part of the implementation of AB 32 emission reductions and allowance allocation methodology. Modesto ID agrees that the Joint Agencies should consider the balance such mechanisms, if properly administered, could bring to the developing market.

In Making Recommendations for the Design and Implementation of a Market System for Emission Allowances a Common Language Must be Used.

A common vocabulary and clear definitions will be critical to the successful implementation of any allowance allocation methodology and larger market system. Toward that end, in response to reference in various comments to “price regulated entities” Modesto ID clarifies that POUs as well as IOUs are “price-regulated entities.” As PG&E notes in its Opening Comments, IOUs are regulated by the CPUC and POUs by their governing public bodies. The Joint Agencies must carefully analyze any recommended allocation methodology and market system to ensure that no competitive preference is created by unnecessary or erroneous distinctions between various service providers.

CONCLUSION

Modesto ID generally recommends that in a market based system implemented to meet emission reduction goals under AB 32, emission allowances should be allocated administratively based at least initially on point of regulations’ historic emissions and accounting for forecasted as well as mandated load growth. Auction of allowances should be minimized and delayed until a robust market has matured. Proceeds from any allowance allocation should be used to reduce emissions, including investments in research and development of new non-emitting generation, renewable energy resources, and programs to encourage energy efficiency. Any market system put in place must be closely monitored by a single, identifiable regulatory body to avoid manipulation, fraud and other abuses.

Respectfully Submitted,

/s/

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November 14, 2007

CERTIFICATE OF SERVICE

I, Linda Fischer, certify under penalty of perjury under the laws of the State of California that the following is true and correct:

On November 14, 2007, I served the attached:

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on the service list for R.06-04-009 by serving a copy of each party by electronic mail, or by mailing a properly addressed copy by first-class mail with postage prepaid to each party unable to accept service by electronic mail.

Copies were also sent by first-class mail with postage prepaid to Commissioner Peevey and Administrative Law Judges Charlotte F. TerKeurst and Jonathan Lakritz.

A copy was also sent by first-class mail with postage prepaid to the California Energy Commission, Docket Office, MS-4, Re: Docket No. 07-OIIP-01, 1516 Ninth Street, Sacramento, CA 95814-5512.

Copies were also served by email to the CEC docket office and to the Project Manager Karen Griffin.

A copy of the service list is attached hereto.

Executed on November 14, 2007, at Modesto, California.

/s/
Linda Fischer

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